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IN THE

Supreme Court of the United States

OCTOBER TERM, 1953

No.

WILLIAM B. STAYBACK, *Petitioner,*

v.

THE UNITED STATES OF AMERICA, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF

To the Honorable Chief Justice and Associate Justices of The Supreme Court of the United States:

The petitioner, William B. Stayback, prays that a writ of certiorari be issued to review the decision of the United States Court of Appeals for the Third Circuit in the above case.

JUDGMENT AND OPINION OF THE COURTS BELOW

The judgment of the United States District Court for the District of New Jersey was entered January 30, 1953 and is not reported but is printed in the Record. (D10a)*

The opinion of the United States Court of Appeals for the Third Circuit is reported at — F. 2d — (R. 228).

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* References with the letter "D" indicate the page numbers of the Appendix for Appellant (Defendant) in the court below, certified as part of the Record.

JURISDICTION

The judgment of the United States Court of Appeals for the Third Circuit was entered April 21, 1954 (R. 228). The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1), 62 Stat. 928.

QUESTIONS PRESENTED

1. Did the Court below extend the Income Tax Act beyond the scope of the Sixteenth Amendment to the Constitution by holding that the Government had only to show unreported *gross receipts* in order to make out an offense under Sec. 145(b), Internal Revenue Code (26 U.S.C.A. sec. 145(b)?

2. Has the Court below in effect shifted the burden of proof to defendant in this criminal case in violation of the Fifth Amendment to the Constitution?

STATUTES INVOLVED

The pertinent provisions of the Internal Revenue Code are set out in the appendix to this petition.

STATEMENT

The petitioner on January 30, 1953, was adjudged guilty as charged on a two-count indictment for filing false and fraudulent income and victory tax returns for the years 1943 and 1944, to which he had pleaded not guilty, and he was sentenced by the United States District Court for the District of New Jersey to imprisonment for eighteen months and fined $3,000 and costs. (D10a)

An appeal was taken to the United States Court of Appeals for the Third Circuit and opinion and judgment were rendered on April 21, 1954 affirming the judgment of the District Court. (R. 228-239)

The petitioner during the years 1943 and 1944 was engaged in the manufacture and sale of metal novelties and souvenirs at 38 Old Broadway, New York, and on Grand

Avenue, Palisades Park, New Jersey. (D41a, D65a-66a, D82a-83a)

For the year 1943 the petitioner and his wife filed a joint individual income and victory tax return (Ex. G-1; D17a, D251a-255a) in which there was reported as income "Net profit from business $8,115.00," computed as follows:

Total Receipts		$15,000.00
Cost of Goods Sold:		
Inventory at beginning of year	$4,000.00	
Materials and supplies	3,585.00	
Total	7,585.00	
Less Inventory at end of year	2,000.00	
Net Cost of goods		5,585.00
Gross profit		9,415.00
Other business deductions:		
Rent, repairs and other expenses (See list)		1,300.00
Net Profit		$ 8,115.00

The deductions for expenses of $1,300 are not in dispute (D159a). There was further deducted on page 1 of the return amounts for contributions, interest and taxes paid, aggregating $980, which are also not in dispute and not here involved (D160a). The return showed net income of $7,135 subject to income tax and $8,115 subject to Victory tax, upon which there was computed a total income and victory tax of $1,534.09. (D149a, D255a)

For the year 1944 petitioner and his wife filed a joint individual income tax return (Ex. G-2; D17a, D256a-258a) in which there was reported as net profit from business $1,553.29, computed as follows:

Total Receipts		$ 4,000.00
Cost of Goods Sold:		
Inventory at beginning of year	$2,000.00	
Materials and supplies	185.61	
Total	2,185.61	
Net Cost of goods		2,185.61
Gross profit		1,814.39
Other business deductions:		
Rent, repairs and other expenses (Schedule G)		261.00
Net Profit		$ 1,553.39

Petitioner Stayback was in business for himself for only two months in 1944 because in March 1944 the business was taken over by the Lee Manufacturing Co. (D31a-32a)

The deductions for expenses of $261.00 are not in dispute (D163a). There was further deducted on said return amounts for contributions, interest and taxes paid, aggregating $975.00, which are also not in dispute. The return showed net income subject to tax $578.39, upon which there was computed income tax of $2.35. (D258a)

Petitioner's tax returns for these two years, 1943 and 1944, were prepared by an accountant, John F. Primoshic, in the year 1946, who testified that the petitioner did not at that time have any books and records for "William Stayback" and that the returns were prepared by him from estimates made by petitioner of his total receipts from business for the year 1943 and for the first two months of 1944, that that was the only income he had, and that he (Primoshic) computed the cost of goods sold and other business deductions (except for rent) stated on the return upon a percentage basis from his knowledge of and familiarity with that particular type of business and his general accounting experience. (D27a-29a, D31a-37a)

Revenue Agent Henry Lieberman, a Government witness, employed by the Bureau from 1944 to 1947, testified on direct examination that he investigated petitioner's affairs in late 1945 and 1946, and that petitioner submitted to him an affidavit explaining why the returns were delinquent, that the petitioner had been in poor health and had been in the Mayo Clinic in Rochester; and that as a result he recommended that no penalty for delinquency be assessed. (D21a-22a, D25a-26a)

Revenue Agent John Cassidy testified that thereafter in 1949 he made an investigation of the returns for the year 1945 of petitioner Stayback and his company, the Lee Manufacturing Company, a corporation which was organized by petitioner to take over the metal novelty business in 1944, and that investigation disclosed that petitioner had made sales under various trade names that were not reported in his returns for the years 1943 and 1944. (D143a-155a)

Mr. Cassidy testified that he went to petitioner's place of business on January 7, 1949 (D150a), which was then located in River Edge, New Jersey (D146a) and interviewed petitioner with reference to the sales under investigation, and that later in April and May 1949 he examined books and records of Lee Manufacturing Co., petitioner's company (D145a) and petitioner gave him some records of his bank account, cancelled checks and check stubs for some months (D165a) and some records for the W.S. Novelty Co., the predecessor business (D167a).

Mr. Cassidy testified that for the year 1943 the total sales were $104,667.38 which was $89,667.38 in excess of the $15,000 sales shown on the return; and that for the year 1944 the total sales were $59,373.40, which was $55,373.40 in excess of the $4,000 sales shown on the return (D156a-157a)

Upon that basis, Revenue Agent Cassidy testified that he recomputed the net income of petitioner for each of the years, using the figures shown on the returns for "cost

of goods sold'' without allowance for any additional costs of manufacture, such as materials, supplies or labor, other than an amount of $16,218.18 payroll (labor) cost for 1943 that he obtained from a payroll exhibit of one of the accounts. (D158a-160a, 194a, 203a) For the year 1943 Mr. Cassidy computed a net income of $80,544.20 and a tax liability of $50,445.53, as follows: (D158a-160a)

Total Receipts		$104,667.38
Costs of Goods sold		
As shown on return	$ 5,585.00	
Plus Payroll (labor)	16,218.18	
Net cost of goods sold		21,803.18
Gross profit from business		82,864.20
Less Business deductions shown on return		1,300.00
Net Profit or net income from business		81,564.20
Less deductions shown on return for contributions, interest and taxes		980.00
Net income		$ 80,584.20
Total tax		$ 50,445.53

For the year 1944 Mr. Cassidy computed a net income of $55,951.79 and a tax liability of $32,197.39, computed as follows: (D162a-163a)

Total Receipts	$ 59,373.40
Net cost of Goods sold as shown on return	2,185.61
Gross profit from business	57,187.79
Less Business deductions shown on return	261.00
Net Profit or net income from business	56,926.79
Less deductions for contributions, interest and taxes shown on return	975.00
Net income	$ 55,951.79
Total tax	$ 32,197.39

Mr. Cassidy testified that he gave the petitioner credit for additional cost of goods in the amount of $16,218.18 for payroll or labor in the 1943 computation but that he didn't give any credit for additional cost of goods in 1944 because he didn't find any, and that petitioner Stayback or his attorney didn't elect to present any at the time of the preparation of his report (D164a).

Mr. Cassidy made no allowance in his computation of net income for either 1943 or 1944 for costs of additional materials or supplies used in the manufacture of the additional sales, notwithstanding the fact that government witness Clifford Allen, Stayback's employee, testified that he purchased quantities of metal for them at the then prevailing price of about five or six hundred dollars a ton; and that a ton of metal would not make a ton of novelties, there being a certain loss in the business; that some of the metal purchases were made in New York and some in Brooklyn; that one place where he purchased metal was Landau, a scrap place on 126th Street, where Allen had bought lead 2 or 3 times, usually a ton at a time; that he also bought metal at Greenpoint Metal in Brooklyn, "maybe once a week"; and that there was one other place he went for metal, in Brooklyn, three or four times during 1943 and 1944. (D112a, D113a, D116a, D119a, D120a, D121a-122a)

(There was no testimony in the case that the foregoing constituted all of the purchases of metal for the petitioner's business in 1943 and 1944.)

Reverting to Mr. Cassidy's testimony, he stated that he did not follow any "net worth" theory in determining the petitioner's taxable income. He just confined himself to the specific items of sales. (D181a-182a)

At the close of the Government's case, counsel for defendant (petitioner) moved for a verdict of acquittal (D203a)

> "because the evidence that has been introduced is as consistent with innocence as it is with guilt, and there

> is nothing upon which the jury could determine a verdict of guilt."

The motion was denied. (D203a)

At the close of the whole case, counsel for the defendant (petitioner) renewed his motion for a verdict of acquittal (D213a)

> "upon the grounds that were set forth at the end of the Government's case,"

and that (D216a-217a)

> "the Government has not sustained the burden of proof that the defendant wilfully intended to evade taxes by understatement of the net income on his returns. The Government has shown only gross sales and gross receipts, and has not proved the gain or profit in the sales. The Government has made no allowance for the cost of materials,"

and that (D219a)

> "in a criminal matter * * * it is the duty of the agents when they make a compilation to set forth * * * the costs of manufacture * * * that go to the marketing of this product, and that hasn't been done in this case,"

and, finally, that (D219a-220a)

> "I fail to find, if your Honor please, in this entire case any evidence of a net income, true net income, * * *."

This motion, also, was denied (D220a).

SPECIFICATION OF ERRORS TO BE URGED

The Court of Appeals for the Third Circuit erred:

1. In holding that petitioner does not dispute the accuracy of the Government's testimony that he understated his "gross income."

2. In holding that the burden was on petitioner to establish the "allowable operating costs" in determining the income received from the additional unreported sales.

3. In holding that the Government by its testimony established "unreported income of almost $90,000 in 1944 (sic) and more than $55,000 in 1943 (sic)."

4. In affirming the judgment of the United States District Court for the District of New Jersey.

REASONS FOR GRANTING THE WRIT

1. The decision of the Court of Appeals is in conflict with decisions of this Court.

The Sixteenth Amendment to the Constitution empowers Congress to levy a tax on income, which means at least gross income and not gross receipts.

The decision of the Court of Appeals for the Third Circuit is in conflict with the decisions of this Court in that the Court approves the Government's computation of petitioner's net income and the tax due thereon from the additional sales for each of the taxable years 1943 and 1944 upon the basis of gross receipts, without allowance for costs of goods sold (except for one labor charge of $16,218 for 1943), which is contrary to the rule laid down in *Southern Pac. Co.* v. *Lowe*, 247 U.S. 330, 335, 38 Sup. Ct. Rep. 540, 62 L. Ed. 1142, 1147, and *Doyle* v. *Mitchell Bros., Inc.*, 247 U.S. 179, 184, 38 Sup. Ct. Rep. 467, 62 L. Ed 1054, 1059, because the gross receipts may include return of capital as well as income and it is very plain that the statute imposes the income tax on the proceeds of the sale of personal property to the extent only that gains are derived therefrom by the vendor. *Goodrich* v. *Edwards*, 255 U.S. 527, 535, 41 Sup. Ct. Rep. 390, 65 L. Ed. 758, 762.

This is a criminal case, and the Government has the burden to prove beyond a reasonable doubt, that the income and the tax due thereon were understated in the return filed.

The Government to establish its case must prove not only an attempt wilfully to defraud but it also must prove that a tax in addition to what the petitioner has already paid remains due and owing. *United States* v. *Schenck*, 126 F. 2d 702, 704 (CCA 2) (Cert. denied 316 U.S. 705). The tax is imposed on net income as distinct from gross income or gross receipts, and the terms are not synonymous. Gross receipts is a broader term, including with it receipts which may constitute capital as well as income, and returns of capital may not be taxed. *Doyle* v. *Mitchell, supra, and Southern Pac. Co.* v. *Lowe, supra.*

Section 21 Internal Revenue Code (26 USCA sec. 21) defines "Net income" as "gross income computed under Section 22, less deductions allowed by Section 23."

"Gross income" as defined in Section 22(a) includes gains, profits, and income derived from business or sales, or the transaction of any business carried on for profit, such as manufacturing business in the present case. Therefore, where a manufacturer processes raw materials and constructs therefrom a finished product, and sells such product, to the extent that the sale price exceeds the cost of goods sold, that is, costs of materials and labor, it is gross income to the manufacturer. *Sunray Oil Co.* v. *Com'r of Internal Revenue*, 147 F. 2d 962, 966 (CCA 10). That definition of gross income is specifically clear from Treasury *Regulations 111* (1946) which provide:

> "Reg. 111, Sec. 29.22(a)-5. Gross income from business.—In the case of a manufacturing, merchandising, or mining business, 'gross income' means the *total sales, less the cost of goods sold*, plus any income from investments and from incidental or outside operations or sources. In determining the gross income subtractions should not be made for depreciation, depletion, selling expenses, or losses, or for items not ordinarily used in computing the cost of goods sold. * * *"
>
> (Emphasis supplied)

Only profits and income from business constitutes gross income. It is only after such profit has so been determined (constituting gross income) that further deductions are

to be made therefrom as authorized by Section 23 I.R.C. in order to arrive at the net income which is taxable. *Anderson Oldsmobile, Inc.* v. *Hofferbert,* 102 F. Supp. 902, 905 (D.C. Md.), affirmed in *Hofferbert* v. *Anderson Oldsmobile,* 197 F. 2d 504, 508 (CCA 4), cert. denied 73 Sup. Ct. Rep. 24.

The gross gain or profit from sales, therefore, must be determined before the allowance of statutory deductions provided in Section 23 I.R.C. There is no express provision that even allows the manufacturer or merchant to deduct the cost of goods that he sells. *Doyle* v. *Mitchell Bros., Inc., supra,* at page 184. Those statutory deductions under Section 23 I.R.C. are generally for expenses in connection with production of income, and are specifically defined in the statute as business expenses, interest, taxes, losses, bad debts, contributions, depreciation, etc.

In this case we are only concerned with the determination of gain or profit on the unreported sales of merchandise, which requires a determination in each year of not only (1) the total gross receipts for such sales, but (2) the costs of materials, supplies and labor that make up the "Cost of Goods Sold." The so-called business deductions for rent, repairs and other expenses, as well as the other statutory deductions for contributions, interest and taxes paid, are not in dispute and are not here involved.

The most important factor in the determination of gross income derived from the manufacture and sale of any product is the cost of goods sold, viz. the cost of materials and the cost of labor.

The Court in its opinion has stated that petitioner (defendant below) does not dispute the accuracy of the Government's testimony that he understated his "*gross income*" by $89,667.39 in 1943 and $55,373.40 in 1944. That is not a correct statement. Those amounts represent the additional *gross sales* (not the gross income) for those years. The Government has the burden to prove the cost of goods sold, viz. cost of materials, supplies and labor, in those sales before the Government may make any determination of "gross income." *Anderson Oldsmobile, Inc.*

v. *Hofferbert, supra,* at page 905. For the year 1943 the Government has allowed $16,218.18 labor costs for additional sales of $89,667.39, but has allowed nothing whatever for costs of materials, such as metal, in the production of those sales. Government witness Allen testified that the cost of metal in those years was $500 to $600 a ton, which would be a substantial factor in the production of sales aggregating $89,667 in 1943 and $55,373 in 1944. (D111a)

For the year 1944 the Government has allowed nothing for costs of either labor or materials in the manufacture of the additional sales of $55,373.40.

The costs of materials listed in the returns as $5,585 for estimated sales of $15,000 in 1943 and the costs of $2,185.61 for estimated sales of $4,000 in 1944, are some indication that in a business of this kind the costs of raw materials used in the manufacture of such products are substantial items. That in itself is proof that the Government has not even attempted to show the gain, profit, or income from the said additional sales, but that it has arbitrarily taxed the entire additional gross sales (less the one labor cost item of $16,218.18) as income to petitioner.

The Court is clearly wrong, therefore, in concluding that the Government has established "*Unreported income.*" Gross receipts and gross sales, without consideration of costs of goods manufactured and sold, are not income as defined by the statute.

The assumption by the Government, by its witness Cassidy and by the Court below, that all of the cost of materials and supplies was reflected in the returns, was not only definitely disproved by the Government's own evidence (witnesses Allen and Primoshic), but was without evidentiary support even from permissible inference on the face of the returns, considered in connection with the corrected "Total receipts." Such an assumption cast the burden of proof upon the petitioner to show that he did not have taxable income in either of the indictment years in excess of the amounts returned. The latter procedure cannot be approved. "It should always be necessary that

the facts and circumstances put in evidence by the Government justify, by reasonable inference at least, the truth of the assumed fact." *Kirsch* v. *United States,* 174 F. 2d 595, 601 (8th Cir. 1949). In the instant case, there was no foundation for the assumption; and the shifting of the burden of proof to the petitioner by such assumption was entirely without warrant in our criminal law. *United States* v. *Fenwick,* 177 F. 2d 488, 492 (CCA 7).

The Government did not produce any evidence of unexplained funds or property in the hands of petitioner, and there was no attempt made to compute petitioner's income on a net worth basis.

The Court below in its opinion states that the burden is on the petitioner to prove that he had other allowable deductions which were not shown on the return, citing *United States* v. *Smith,* 206 F. 2d 905 (CCA 3), *United States* v. *Link,* 202 F. 2d 592 (CCA 3), and *United States* v. *Hornstein,* 176 F. 2d 217 (CCA 7). But in a criminal case the burden of proof is on the Government.

The *Smith* case involved only items of dividends, interest and capital gains and did not require the computation of net profits from a manufacturing business. The *Link* case was that of a bookmaker and the figures for both gross rec pts and deductions were proven by the Government. There, the Government allowed deductions of $800,000 from gross receipts of $1,063,000 and thus sustained its burden of proof.

The *Hornstein* case was that of a diamond merchant whose tax returns were prepared by accountants at his request from books and records furnished to them by Hornstein, which records showed substantial amounts as costs of goods sold, $16,847 for 1941 and $47,581 for 1942; and in addition defendant showed purchases of goods in 1942 of $66,426.50. Furthermore, the defendant attempted to produce evidence that the figures were in error and that the costs were greater than that shown by the books. The Government, therefore, maintained its burden of proof in showing the costs of goods sold from the evidence produced in his books and records and evidence of purchases of

$66,426.50 goods in 1942. That is an entirely different situation from the present case, where the petitioner had no records and the Government proved no costs of materials and only proved one item of labor costs for all of the additional sales aggregating $89,667 in one year and $55,373 in the other year.

Indeed, if it were not for the fact that each of the tax returns for 1943 and 1944 stated that there was taxable income, the Government's evidence would have been insufficient to establish that there was *any* taxable income for either year. *A fortiori,* the Government's proof is insufficient to establish that the petitioner was in receipt of a taxable income in either of the indictment years *exceeding* the amounts reported by him in the respective returns. This is so because, in order to justify the submission of a criminal cause of the instant character to the jury, there must be substantial evidence of facts which exclude every other hypothesis but that of guilt. *Nicola* v. *United States,* 72 F. 2d 780, 786 (Third Circuit, 1934); *United States* v. *Fenwick, supra.* The case at bar should not have been submitted to the jury by the trial judge, since the Government's proofs did not exclude the hypothesis that the total "cost of goods sold" in either of the indictment years, especially including the cost of raw materials, may have been so large that the gross income shown on the tax returns was not understated.

2. The Decision of the Court Below Shifts the Burden of Proof to Petitioner in Contravention of the Fifth Amendment to the Constitution.

This case raises a question of the scope and application of protection afforded petitioner by the Fifth Amendment to the Constitution. The Court below has so far departed from the accepted and usual course of judicial proceedings, or so far sanctioned such a departure by the District Court, as to call for an exercise of this Court's power of supervision and warrant the granting of the writ.

The burden is upon the Government to prove guilt beyond a reasonable doubt, and to prove facts consistent

with a state of guilt and inconsistent with a state of innocence. The rule imposes upon the Government the burden of proving the existence of every element necessary to constitute the crime charged. *Davis* v. *United States,* 160 U.S. 469, 487-88, 16 Sup. Ct. Rep. 353, 40 L. Ed. 499, 505-6. Thus, in the present case, the Government has the burden to prove unreported gross income and the tax resulting from the additional sales in each year, after subtraction of the cost of goods sold.

The mere sale in itself is not a presumption of profit, and if there is no profit there is no income and no tax due. The petitioner was the only person who could testify in contradiction of the Government's charge. See *Tot* v. *United States,* 319 U.S. 463 (1943), 63 Sup. Ct. 1241, 87 L. Ed. 1519.

If, therefore, as the Court below ruled, the burden is shifted to petitioner (defendant below) to prove the negative, and to prove that no income was realized on the additional sales and no tax resulted therefrom, then he is compelled, in violation of the Fifth Amendment to the Constitution, to take the stand and be a witness in a proceeding against himself. In such case the Court would deprive petitioner of life, liberty, and property without due process of law.

The decision of the Court below has sanctioned such a departure by the District Court from the accepted and usual course of judicial proceedings as to violate the Fifth Amendment to the Constitution.

CONCLUSION

For the foregoing reasons it is respectfully submitted that this petition for a writ of certiorari should be granted.

RICHARD S. DOYLE
JOHN E. TOOLAN
JULES G. KÖRNER III
Counsel for Petitioner

Of Counsel:
BLAIR, KÖRNER, DOYLE & APPEL
TOOLAN, HANEY & ROMOND

APPENDIX

Statute Involved

The pertinent provisions of the Internal Revenue Code are:

Sec. 145. Penalties

* * *

(b) Failure to collect and pay over tax, or attempt to defeat or evade tax. Any person required under this chapter to collect, account for, and pay over any tax imposed by this chapter, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than five years, or both, together with the costs of prosecution.

26 USCA Sec. 145(b), 52 Stat. 513.

* * * * *

Sec. 21. Net income

(a) Definition. "Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

26 USCA Sec. 21(a), 52 Stat. 457.

* * * * *

Sec. 22. Gross income

(a) General definition. "Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, or profit, or the transaction of any business car-

ried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

26 USCA Sec. 22(a), 52 Stat. 457, 53 Stat. 575.

* * * * *

Sec. 23. Deductions from gross income. In computing net income there shall be allowed as deductions:

(a) Expenses

(1) Trade or business expenses.

(A) In general. All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *.

26 USCA Sec. 23(a), 52 Stat. 460.

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In the Supreme Court of the United States

OCTOBER TERM, 1954

No. 89

WILLIAM B. STAYBACK, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the Court of Appeals (R. 228-239)[1] is reported at 212 F. 2d 313.

JURISDICTION

The judgment of the Court of Appeals was entered April 21, 1954 (R. 240), and the petition for

[1] The record in this Court consists of the separate appendices filed in the Court of Appeals by the appellant and the appellee. References to the appellant's appendix will be designated as "D.", and to that of the appellee as "R."

a writ of certiorari was filed May 21, 1954. The jurisdiction of this Court is invoked under 28 U. S. C. 1254(1). See also Rules 37(b)(2) and 45(a), Federal Rules of Criminal Procedure.

QUESTION PRESENTED

Petitioner was indicted and tried for wilfully attempting to defeat and evade his and his wife's income taxes. The Government's proof showed that he had reported only a small fraction of the gross receipts of his business, that he produced no books, that he refused to reveal to the revenue agents any costs offsetting the unreported receipts, and that the Government had determined actual gross income and net income by allowing all deductions which he had claimed in the income tax returns and such other costs as the investigation disclosed. The question presented is:

Whether the Government's proof of petitioner's actual gross income and net income was sufficiently definite to warrant a jury in concluding beyond a reasonable doubt that an additional tax was due and owing.

STATUTE INVOLVED

Internal Revenue Code:

> SEC. 21. NET INCOME
>
> (a) *Definition.* "Net income" means the gross income computed under section 22, less the deductions allowed by section 23.
>
> * * * * *
>
> (26 U.S.C. 1946 ed., Sec. 21.)

SEC. 22. GROSS INCOME

(a) *General Definition.* "Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(b) *Exclusions from Gross Income.* * * *

(c) *Inventories.* Whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

* * * * *

(n) [as added by Sec. 8(a), Individual Income Tax Act of 1944, c. 210, 58 Stat. 231] *Definition of "Adjusted Gross Income".* As

used in this chapter the term "adjusted gross income" means the gross income minus—

(1) *Trade and business deductions.* * * *

(2) *Expenses of travel and lodging in connection with employment.* * * *

(3) *Reimbursed expenses in connection with employment.* * * *

(4) *Deductions attributable to rents and royalties.* * * *

(5) *Certain deductions of life tenants and income beneficiaries of property.* * * *

(6) *Losses from sales or exchange of property.* * * *

(26 U. S. C. 1946 ed., Sec. 22.)

SEC. 145. PENALTIES.

* * * * *

(b) *Failure to Collect and Pay Over Tax, or Attempt to Defeat or Evade Tax.*—Any person required under this chapter to collect, account for, and pay over any tax imposed by this chapter, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000, or imprisoned

for not more than five years, or both, together with the costs of prosecution.

* * * * *

(26 U. S. C. 1946 ed., Sec. 145.)

STATEMENT

On April 17, 1952, a two-count indictment was returned against petitioner in the United States District Court for the District of New Jersey charging him with having wilfully attempted to defeat and evade his and his wife's income taxes for the calendar years 1943 and 1944, in violation of Section 145(b) of the Internal Revenue Code. (D. 1-3.) After a jury trial lasting approximately three weeks, petitioner was found guilty as charged (D. 16, 221, 250), and on January 30, 1953, he was sentenced to eighteen months imprisonment on each count, the prison sentences to run concurrently, and was fined a total of $3,000 (D. 10). The Court of Appeals affirmed the conviction. (R. 240.)

The evidence to support the verdict may be briefly summarized as follows:

Petitioner was engaged in the manufacture of metal novelties during 1943 and 1944. (D. 28, 82.) He did not file timely income tax returns for those years (D. 17), although an employee prepared a 1943 return for him on March 15, 1944 (R. 167-171, 199-200). Delinquent returns for both years were finally filed after a revenue agent visited his place of business in 1946 and requested that returns be

submitted.[2] (D. 17, 22-24.) The accountant who prepared them obtained his information orally from petitioner since petitioner produced no records. He told the accountant that as nearly as he could remember the total sales from the business, which was his only source of income, amounted to $15,000 in 1943 and $4,000 in 1944. He furnished no figures for costs and expenditures, and the accountant estimated what these must have been on the basis of his own experience in the metal novelty business. Petitioner accepted the accountant's figures as correct. (D. 27-37, 251-258; cf. R. 168.) According to the 1943 return his net income was $7,135 on which the tax was $659.25. (D. 17, 251, 255.) The 1944 return disclosed net income of $578.39 and a tax of $2.35. (D. 20, 256, 258.)

In 1949 the Internal Revenue Service undertook an investigation of these returns. (D. 145-147.) The agents soon discovered that, in addition to operating under his own name, petitioner also carried on business during 1943 and 1944 under the names of W. S. Novelty Company, S. Pannone, Clifford Allen, Harlem Chromium Plating Company, George Wilson Specialty Company, and Universal Alarm Corporation. (D. 53-55, 56-59, 82-86, 111-114; R. 11-21, 31-41, 54, 55-74, 104.) By contacting the customers to whom petitioner had sold merchan-

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[2] The original delinquent returns were submitted to the revenue agent in April and October 1946. (D. 24.) Amended returns, decreasing the tax liability, were filed on December 13, 1946. (D. 17, 27; R. 4-5.)

dise the agents determined that his total sales amounted to $104,667.38 during 1943 and $59,373.40 during 1944. The returns had, therefore, omitted sales of $89,667.38 in 1943 and $59,373.40 in 1944. (D. 155-157.) The checks received from customers in payment for these sales had frequently been made payable to cash, and they were cashed for petitioner either by the customer or by a check cashing concern instead of being deposited in a bank. (D. 115-119; R. 28, 33-38, 58-59, 64-72, 79-83, 112.) Petitioner's employees received this cash and either turned it over to petitioner or used it to purchase metal for use in the business. (D. 116-122; R. 57-59, 68-72, 77, 79-87, 100.)

After the agents had discovered these unreported sales they informed petitioner of the facts and asked him whether he had records of additional offsetting costs. (D. 150-152.) Petitioner said he could not substantiate any additional costs (D. 164, 173) and his attorney, when asked for such evidence, told the agents that "he did not elect to present any" (D. 164, 170, 199-203; R. 161-163). No records of manufacturing costs were ever presented to the agents, although the investigation was held open for over a year, the evidence of unreported sales was fully explained to petitioner's attorney, and frequent requests were made for information on costs. (D. 170, 173, 199, 202; R. 159-163.) Inquiries were made of petitioner's suppliers, but the only additional cost item the agents could discover during their investigation was approximately $16,000 expended for labor during 1943. (D. 159-160, 164,

169-173, 175-177, 194; R. 166.) Taking this item into account, and allowing all other deductions claimed in the returns, the Government computed a tax deficiency of $49,130.15 for 1943 and $32,-195.04 for 1944. (D. 158-164.)

The only other evidence of manufacturing costs at the trial was the vague testimony of petitioner's employee, Allen, that he bought lead at $500 or $600 a ton about once a week (D. 112-122), and the testimony of petitioner's wife that they used only two or three tons of metal in 1943 at a cost of $200 a ton (R. 196-198).

The trial judge carefully charged the jury that the burden was on the Government to prove beyond a reasonable doubt that petitioner owed additional taxes over and above those reported in his returns. He distinguished net income from gross income, and he told the jury the Government could not prove additional taxes simply by showing unreported sales, but that it must show further that these sales, after deduction of costs for materials and labor, resulted in net taxable income in excess of that reported by petitioner. (D. 223-228, 230-232.) The specific instructions presented by the defense on this aspect of the case were given by the court substantially as requested. (D. 243-244, 246-247.)

ARGUMENT

In order to establish a violation of that portion of Section 145(b) of the Internal Revenue Code (*supra*, pp. 4-5) under which petitioner was indicted, the Government must prove (1) that an additional

income tax was due and owing; (2) that an attempt was made to evade this additional tax; and (3) that the attempt was wilful. Petitioner's sole concern (Pet. 11) is with the first of these three elements. He does not challenge the proof of the other two. He contends that the courts below erroneously permitted the Government to compute his income tax. for 1943 and 1944 on the basis of his gross receipts, without deducting the cost of goods sold, instead of on the basis of his gross income (Pet. 9-14); and that, therefore, the burden was improperly shifted to him to prove, both what his gross income was, and that he owed no additional taxes (Pet. 14-15). In brief, petitioner's contention is that the Government's evidence was insufficient to establish that additional taxes were due.

We submit that the Government determined petitioner's gross income with sufficient definiteness to provide the basis for a conclusion beyond a reasonable doubt that he did owe taxes over and above those reported in his returns. We agree with petitioner that "gross receipts" is a broader term than "gross income", that all returns of capital must be excluded from the former in order to obtain the latter, and that the determination of gross income is an essential step in the computation of the tax. *Southern Pacific Co.* v. *Lowe,* 247 U. S. 330, 335; *Burnet* v. *Logan,* 283 U. S. 404, 413; *Doyle* v. *Mitchell Brothers Co.,* 247 U. S. 179, 185. The tax is, of course, ultimately computed on the basis of net income, determined by the elimination of all non-income receipts and allowable deductions. Be-

ginning with gross receipts, excludible items (life insurance, annuities, gifts, etc.) and returns of capital (determined, where necessary, by the use of inventories) are eliminated to obtain gross income. Gross income minus allowable business deductions equals adjusted gross income, and this latter, minus allowable deductions for non-business expenditures, equals net income. Sections 21 and 22, Internal Revenue Code (*supra*, pp. 2-4).

This is exactly the method by which the Government determined petitioner's net income for the taxable years involved in this case. The Government started with a figure representing the gross receipts for each particular year, a figure vastly exceeding that appearing in the return because of the numerous unreported sales uncovered by the investigation. (*Supra*, pp. 6-7.) The Government could not determine whether any portion of these unreported receipts represented an offsetting return of capital expended for raw materials, supplies and labor, with the exception of the $16,000 item for labor in 1943. Frequent requests addressed to petitioner and his attorney, to whom the full extent of the unreported sales had been made clear, failed to evoke any pertinent information, and inquiries made of petitioner's suppliers were fruitless. (*Supra*, p. 7.) In order to determine petitioner's gross income, therefore, the Government subtracted from his actual gross receipts the $16,000 labor item in 1943 and the cost of raw materials and supplies as reported in the returns. Adjusted gross income was then determined by

subtraction of other business deductions as reported by petitioner. Finally, net income was determined by subtraction of the reported non-business deductions. (D. 155-163, 251-258; see Pet. 3-7.) As to the Government's figure for actual gross receipts, and as to the last two steps in the above computation, there is no dispute.[3] (Pet. 3, 4, 11.) The only question is whether the Government's case must fail because the agents could discover no additional offsetting costs of labor and materials, or whether, to state the converse, the Government established a substantial amount of unreported gross income with sufficient definiteness to permit a jury to conclude beyond a reasonable doubt that additional income taxes were due and owing.

It was, of course, unnecessary for the Government to prove the exact amount of the evaded tax. The prosecution sustained its burden if it proved the evasion of some substantial amount. *United States* v. *Johnson,* 319 U. S. 503, 517. And the Government's evidence was sufficient to support the verdict if reasonable minds, regarding that evidence in the light most favorable to the Government, could conclude beyond a reasonable doubt that petitioner had evaded some substantial amount of his taxes. *United States* v. *Socony-Vacuum Oil Co.,* 310 U. S. 150, 254; *Glasser* v. *United States,*

[3] Although the Court of Appeals said (R. 233) that there was no dispute as to the Government's "gross income" figures, the context of the opinion shows that the term was being used in the sense of "gross receipts" (R. 231-233; see Pet. 8, 11).

315 U. S. 60, 80; *Gorin* v. *United States,* 312 U. S. 19, 32; *Pierce* v. *United States,* 252 U. S. 239, 251-252; *Stilson* v. *United States,* 250 U.S. 583, 588-589; *Curley* v. *United States,* 160 F. 2d 229, 232-233 (C.A. D.C.), certiorari denied, 331 U. S. 837; *Gendelman* v. *United States,* 191 F. 2d 993, 995 (C.A. 9th), certiorari denied, 342 U. S. 909. The Government's proof clearly met this test.

In the first place, while it is undisputed that the returns understated by a wide margin petitioner's total sales or gross receipts,[4] the evidence shows that only a certain percentage of these receipts represented offsetting costs or return of capital. When petitioner's accountant, Primoshic, prepared the delinquent returns he drew on his accounting experience to determine these costs at a certain percentage of the total sales and petitioner agreed that this computation was correct. (*Supra,* p. 6.) Liebman, the accountant who testified for petitioner at the trial, also appears to have recognized that deductible costs represented only a portion of total sales. (See colloquy D. 217-218; R. 206-207.) Consequently, since gross income was so largely understated in the returns, the only logical inference is that net income was also understated in proportion, and that a substantial amount of the correct tax was evaded.

Furthermore, petitioner's conduct during the investigation points inevitably to the conclusion

[4] The total sales of his business represented his annual gross receipts since he had no other source of income. (D. 251-252, 256-257.)

that, if he had produced all the evidence of his manufacturing costs, his net income would then clearly be seen to have been substantially understated. When the first agent who visited him in 1946 requested returns for 1943 and 1944 he presented returns which so grossly understated his true receipts that it is inconceivable that he could have been mistaken, and, in fact, no such contention has been made. And when the agents, after further investigation, confronted him with the evidence of unreported sales, neither he nor his attorney, despite frequent requests, would present any substantiation of offsetting costs. Meanwhile, inquiries directed to petitioner's suppliers failed to produce evidence of additional costs. Obviously, even if there were any additional costs, and even if they had been deducted from the actual gross receipts, there still would have remained a substantial amount of unreported gross income.

The force of a *prima facie* case may not be defeated by such "skilful concealment." *United States* v. *Johnson,* 319 U. S. 503, 517-518. Since the circumstances fairly indicated that there were no costs to offset the greater portion of the unreported sales, it was not incumbent on the Government to adduce further positive evidence in support of this negative proposition. *United States* v. *Fleischman,* 339 U. S. 349, 360-364; *Rossi* v. *United States,* 289 U. S. 89, 91-92. This was not a case in which petitioner himself was the only person who could testify in contradiction of the Government's case. (Pet. 15.) If he actually had

offsetting expenses for material, his suppliers were certainly available to him. Where the Government has established unreported gross income and where it has allowed all deductions claimed by the taxpayer in his returns and such others as it can determine by a complete investigation, and where the taxpayer when confronted with the results of the investigation refuses to produce evidence of further deductions, a reasonable jury may conclude beyond a reasonable doubt that there were no sufficient additional deductions to make any substantial difference in the Government's case. See *United States* v. *Link*, 202 F. 2d 592, 593-594 (C.A. 3d); *United States* v. *Hornstein*, 176 F. 2d 217, 220 (C.A. 7th); cf. *Burka* v. *Commissioner*, 179 F. 2d 483, 485 (C.A. 4th).

CONCLUSION

For the reasons stated it is respectfully submitted that the petition for a writ of certiorari should be denied.

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